Supreme Court, U.S.
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No. 02-

IN THE

Supreme Court of the United States

SECURITIES AMERICA, INC.,

Petitioner,

v.

CHARLES P. ROGERS, *et al.*,

Respondents.

ON PETITION FOR A WRIT OF CERTIORARI
TO THE SUPREME COURT OF ALABAMA

PETITION FOR A WRIT OF CERTIORARI

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QUESTION PRESENTED

Under the Federal Arbitration Act, does the severability doctrine insulate arbitration agreements found in other agreements from allegations that the underlying agreements are illegal where no challenge is made to the legality of the arbitration agreement itself?

PARTIES TO THE PROCEEDINGS

The Petitioner is Securities America, Inc.

The Respondents are the following individuals who were parties to the proceedings below: The Singatory Plaintiffs were Adrian Ringland, Jr., Adrian Ringland, III, Bertha Ringland, George Edwards, and John Taliaferro. The Non Signatory Plaintiffs were M. Khris McAllister, Robert F. McCollough, Charles P. Rogers, Margaret Rogers, and William S. Ringland.

Scott Jonathon McKay Wolas a/k/a Robert Francis McDowell a/k/a Allen Lee Hengst and "Fictitious Parties A-E" were named as Defendants in the Circuit Court of Jefferson County Alabama, but were never served and did not participate in the proceedings below.

CORPORATE DISCLOSURE STATEMENT

Petitioner Securities America, Inc. is wholly owned by Securities America Financial Corporation, which is wholly owned by American Express Financial Corporation, which is wholly owned by American Express Company.

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PETITION FOR A WRIT OF CERTIORARI

Securities America, Inc. ("SAI") respectfully petitions this Court for a writ of certiorari to review the judgment of the Supreme Court of Alabama in this case.

OPINIONS BELOW

The Jefferson County Circuit Court's order denying Petitioner's motion to compel arbitration (Pet. App. 15a), and the Alabama Supreme Court's opinion affirming that judgment (Pet. App. 1a-14a), are unpublished. They are both reproduced in the appendix.

STATEMENT OF JURISDICTION

The judgment of the Alabama Supreme Court was entered November 8, 2002. A timely motion for rehearing was denied February 7, 2003. (Pet. App. 16a.) On May 8, 2003, Justice Kennedy, as Circuit Justice, granted a 15 day extension of time in which to file this petition through and including May 23, 2003. The jurisdiction of this Court is invoked under 28 U.S.C. § 1257(a).

RELEVANT STATUTORY PROVISIONS

The relevant provisions of the Federal Arbitration Act ("FAA"), 9 U.S.C. §§ 1, 2, 3 and 4 are reproduced in the appendix (Pet. App. 17a-19a).

The relevant provisions of Alabama law are also reproduced in the appendix. (Pet. App. 19a-20a).

STATEMENT OF THE CASE

The decision of the Alabama Supreme Court in this case is an example of judicial hostility to enforcement of arbitration clauses. In this case it is undisputed that the arbitration agreements were actually made, affect interstate commerce and

cover the Plaintiffs' claims. Nevertheless, the Alabama Supreme Court refused to compel arbitration, and in so doing made no mention whatsoever of federal law, though it was emphasized by Petitioner. It was the eradication of such hostility that motivated the adoption of the Federal Arbitration Act and this Court's expansion of its application to the fullest reaches of Congress' power under the Commerce Clause. *See, e.g.*, *Prima Paint Corp. v. Flood & Conklin Mfg. Co.*, 388 U.S. 395 (1967); *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1 (1983); *Southland Corp. v. Keating*, 465 U.S. 1 (1984); *Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265 (1995).

Indispensable to substantive federal law of arbitration is the "severability" doctrine. "That the Arbitration Act envisages a distinction between the entire contract between the parties on the one hand and the arbitration clause of the contract on the other is plain on the face of the statute." *Robert Lawrence Co. v. Devonshire Fabrics, Inc.*, 271 F.2d 402, 409 (2nd Cir. 1959), *cert. dismissed*, 364 U.S. 801 (1960). Under the severability doctrine, which is clearly ordained in the text of the Federal Arbitration Act at §§ 2 and 4, a general attack on the validity of the underlying agreement does not affect the validity of the separate and distinct arbitration agreement. Thus, in considering a motion to compel arbitration, the statute focuses the court's attention upon the question of whether there is an issue as to "the making of the agreement for arbitration or the failure to comply therewith." 9 U.S.C. § 4. If not, the court "shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement." *Id.*; *Prima Paint*, 388 U.S. at 403-404. A claim which goes only to the validity of the underlying agreement, such as fraud in the inducement, does not affect the validity or enforceability of the "separate" agreement to arbitrate, and so does not create an issue as to "the making of the agreement for arbitration," and therefore cannot be considered in passing on a motion for stay or to compel arbitration. *Id.* at 404. The only claim that may be considered in

the context of a motion for stay or to compel arbitration is one that actually does create an issue as to the making of the agreement to arbitrate specifically, such as fraud in the inducement of the agreement to arbitrate, lack of consent, etc. *Id.*

Consequently, where the attack on the underlying contract does not raise any issue as to the making of the arbitration agreement, and the attack on the underlying contract is within the scope of the issues the parties agreed to arbitrate, courts have routinely ordered that claims of fraud in the inducement and other similar generalized attacks on the underlying agreement be decided by an arbitrator rather than a court. This is the teaching of *Prima Paint.*

To avoid the arbitration they plainly agreed to, Respondents attacked their underlying customer agreements with SAI as being unenforceable under the Alabama Securities Act on the grounds that the man with whom they dealt did not hold a securities license in his real name – Scott Wolas – though he was licensed in the name of the assumed identity by which he was known to both Petitioner and Respondent in all their dealings with him – Allen Lee Hengst. Neither Petitioner SAI nor Respondents had any inkling that Allen Lee Hengst was not who he appeared to be, fully and properly licensed, until *after* he had absconded. Under the Alabama statute, it is unlawful to transact business as a dealer or agent for securities without a license, and no one who makes or performs a contract in violation of this requirement can enforce such a contract. Ala. Code §§ 8-6-3, 8-6-19(g). It is undisputed that Respondents' claims are within the scope of the broad arbitration clause here at issue, that the parties in fact agreed to arbitration, and that the attack is not on the arbitration agreement particularly, but on the underlying agreement generally. On these facts, and in the face of the plain text of the FAA, and the established precedents of this Court to the contrary, the Alabama Supreme Court concluded that the illegality of the underlying agreement is not severable from and

is fatal to the arbitration agreement, and that a court, not an arbitrator, should address and resolve issues that are otherwise plainly within the scope of the arbitration agreement.

This conclusion by the Alabama Supreme Court is directly contrary to the Federal Arbitration Act and this Court's decisions applying it from *Prima Paint* forward, as well as the decisions of most other courts that have directly addressed the issue. Certiorari should be granted (1) to revisit for the benefit of the Alabama Supreme Court the contours of the supremacy of federal substantive law governing arbitration agreements, *see, e.g., Allied-Bruce Terminix Companies, Inc. v. Dobson*, 513 U.S. 265, 115 S. Ct. 834 (1995), (2) to correct the other courts that have likewise gone astray in this area, and (3) to eliminate the mischief arising from doctrinal confusion that has crept into the decisions of several circuit and state courts.

I. Statutory Background

1. Federal Statutes

The FAA provides that written arbitration provisions shall be "valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract." 9 U.S.C. § 2. Furthermore, a court, state or federal, is under an obligation to stay proceedings in that court "upon any issue referable to arbitration under an agreement in writing for such arbitration. . . ." 9 U.S.C. § 3. Once a demand for arbitration is made by one party and opposed by another, the demanding party may petition the court to compel arbitration of that dispute. 9 U.S.C. § 4. If the court is satisfied that "the making of the agreement for arbitration or the failure to comply therewith is not in issue," the FAA requires that court direct the parties to arbitrate disputes whenever the parties have signed an agreement requiring them to do so. *Id.* However, if issues exists regarding the making of the arbitration agreement, the court is required decide these issues. *Id.*

In *Allied-Bruce Terminix Cos, Inc,. v. Dobson, supra,* also on certiorari from the Supreme Court of Alabama, the Court explained the historical backdrop and purposes of the Federal Arbitration Act, 9. U.S.C. § 1, *et seq.*:

> First, the basic purpose of the Federal Arbitration Act is to overcome courts' refusals to enforce agreements to arbitrate. *See Volt Information Sciences, Inc. v. Board of Trustees of Leland Stanford Junior Univ.*, 489 U.S. 468, 474, 109 S. Ct. 1248, 1253, 103 L. Ed. 2d 488 (1989). The origins of those refusals apparently lie in "'ancient times,'" when the English courts fought "'for extension of jurisdiction – all of them being opposed to anything that would altogether deprive every one of them of jurisdiction.'" *Bernhardt v. Polygraphic Co. of America, Inc.*, 350 U.S. 198, 211, n.5, 76 S. Ct. 273, 280, n.5, 100 L. Ed. 199 (1956) (Frankfurter, J., concurring) (quoting *United States Asphalt Refining Co. v. Trinidad Lake Petroleum Co.*, 222 F. 1006, 1007 (S.D.N.Y. 1915), in turn quoting *Scott v. Avery*, 5 H.L.Cas. 811 (1856) (Campbell, L.J.)). American courts initially followed English practice, perhaps just "'stand[ing] . . . upon the antiquity of the rule'" prohibiting arbitration clause enforcement, rather than "'upon its excellence or reason.'" *Bernhardt v. Polygraphic Co., supra*, 350 U.S., at 211, n.5, 76 S. Ct., at 280, n.5 (quoting *United States Asphalt Refining Co., supra*, at 1007). Regardless, when Congress passed the Arbitration Act in 1925, it was "motivated, first and foremost, by a . . . desire" to change this antiarbitration rule. *Dean Witter Reynolds Inc. v. Byrd*, 470 U.S. 213, 220, 105 S. Ct. 1238, 1242, 84 L. Ed. 2d 158 (1985). It intended courts to "enforce [arbitration] agreements into which parties had entered," ibid. (footnote omitted), and to "place such agreements 'upon the same

> footing as other contracts,'" *Volt Information Sciences, Inc., supra*, 489 U.S. at 474, 109 S. Ct., at 1253 (quoting *Scherk v. Alberto-Culver Co.*, 417 U.S. 506, 511, 94 S. Ct. 2449, 2453, 41 L. Ed. 2d 270 (1974).

Allied-Bruce Terminix Companies, Inc. v. Dobson, 513 U.S. at 270.

In order to carry out the purposes of the Arbitration Act, this Court has extended its reach "to the limits of Congress' Commerce Clause power." *Allied-Bruce Terminix Cos. Inc. v. Dobson*, 513 U.S. 265, 270. In addition, the Court has held that federal arbitration law is substantive in nature, is applicable in both state and federal courts and pre-empts any contrary state law, whether statutory or judge-made:

> In *Moses H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. at 1, 25, and n.32, we reaffirmed our view that Arbitration Act 'creates a body of federal substantive law' and expressly stated what was implicit in *Prima Paint*, i.e., the substantive law the Act created was applicable in state and federal court.

Southland Corp. v. Keating, 465 U.S. 1, 12 (1984); *Allied-Bruce, supra*, 513 U.S. at 270. "In enacting § 2 Congress declared a national policy favoring arbitration and withdrew the power of the states to require a judicial forum for the resolution of claims which the contracting parties agreed to resolve by arbitration." *Southland Corp. v. Keating*, 465 US at 10.

2. Alabama Statutes

Alabama Code § 8-6-3, part of the Alabama Securities Act, provides that it is "unlawful" for any person to transact business in the state as a dealer or agent for securities, as an investment adviser or an investment adviser representative unless he or she are registered under the Alabama securities statutes. Section 8-

6-19(g) provides that contracts made or performed in violation of this provision are unenforceable:

> No person who has made or engaged in the performance of any contract in violation of any provision of this article or any rule or order hereunder or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any action on the contract.

The purpose of the Alabama Securities Act is to "protect the public from fraudulent, dishonest, or unethical practices in the securities business." *Securities America, Inc. v. Rogers*, (Pet. App. 10a); Comment to Ala. Code § 8-6-3. To carry out this policy, the Alabama Supreme Court construed both § 8-6-3 and § 8-6-19 "most favorably to the public." (Pet. App. 10a, 11a).

II. Factual Background

Defendant SAI is a broker-dealer registered with the United States Securities and Exchange Commission and is a member of the National Association of Securities Dealers (the "NASD").

In May, 2000, SAI registered a securities representative under the Alabama Securities Act. This man was registered under the name "Allen Lee Hengst", the name by which he was known and registered during three previous years of employment in the securities business and the only name by which he was known at the time to either Plaintiffs or SAI.

The Plaintiffs' claims stem from their dealings with "Hengst". Unbeknownst to either the Plaintiffs or SAI, "Hengst" was an assumed name. The true, and secret, identity of "Hengst" was Scott Wolas.

The real Allen Hengst is a law librarian, and was Wolas' college roommate. The real Hengst will be referred to as the "Librarian" to distinguish him from the "Hengst" identity assumed by Scott Wolas.

Wolas surfaced in Orlando, Florida in 1997, and obtained a securities license using the Librarian's name and Social Security number. He worked for three years with the brokerage firm Chatfield Dean and its successor, J.W. Genesis (collectively "Genesis"). In May 2000, Wolas, using the name "Hengst," became registered with SAI.

During the time he was employed by Genesis and SAI, and unbeknownst to SAI, "Hengst" operated a Ponzi scheme in which he persuaded both customers and noncustomers of SAI to invest with him personally in gold certificates. Plaintiffs below were among those who invested in this Ponzi scheme, and lost money.

Five of the ten Plaintiffs below, Adrian Ringland, Jr. Adrian Ringland, III, Bertha Ringland, George Edwards, and John Taliaferro (the "Signatory Plaintiffs") opened brokerage accounts and signed New Account Agreements with SAI.[1]

The New Account Agreements contain the following language directly above the customer signature line:

> I HEREBY ACKNOWLEDGE THAT I AM IN RECEIPT AND HAVE READ, UNDERSTOOD AND AGREED TO THE TERMS SET FORTH IN THE SAI CLIENT AGREEMENT AND THAT THIS ACCOUNT IS GOVERNED BY A PRE-DISPUTE ARBITRATION AGREEMENT WHICH I HAVE READ AND UNDERSTAND.

(Pet. App. 3a.)

The Pre-Dispute Arbitration Agreement to which this passage refers is found in the SAI Client Agreement. It is given

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1. SAI moved to compel the five other "Non-Signatory Plaintiffs" to arbitrate. The trial court denied that motion and the Alabama Supreme Court affirmed that denial. Those claims are not the subject of this petition.

to all prospective SAI customers before they sign the New Account Agreement. The Arbitration Agreement provides in relevant part:

> I AGREE THAT ALL CONTROVERSIES THAT MAY ARISE BETWEEN US CONCERNING ANY ORDER OR TRANSACTION, OR THE CONTINUATION, PERFORMANCE OR BREACH OF THIS OR ANY OTHER AGREEMENT BETWEEN US, WHETHER ENTERED INTO BEFORE, ON, OR AFTER THE DATE THIS ACCOUNT IS OPENED, SHALL BE DETERMINED BY ARBITRATION BEFORE A PANEL OF INDEPENDENT ARBITRATORS SET UP BY EITHER THE NEW YORK STOCK EXCHANGE, INC. OR NATIONAL ASSOCIATION OF SECURITIES DEALERS INC. AS I MAY DESIGNATE.

(Pet. App. 5a.)

In December, 2000 "Hengst" absconded. It was thereafter discovered that "Hengst" was actually Wolas. This litigation, and others like it, followed.

III. History of Proceedings

1. Proceedings before the Jefferson County Circuit Court

On October 19, 2001, the Plaintiffs filed a Complaint in the Circuit Court of Jefferson County, Alabama, against SAI and Wolas alleging that Plaintiffs had made financial investments with SAI by and through "Hengst."

On December 13, 2001, SAI answered the Complaint and asserted, among other defenses, that Plaintiffs' claims were subject to mandatory arbitration agreements and should be pursued, if at all, in arbitration. On that same day, SAI filed a

Motion to Dismiss, or Alternatively, to Stay and Compel Arbitration ("Motion to Compel Arbitration"). SAI argued that the Signatory Plaintiffs (who undisputedly signed the arbitration agreements) were required to arbitrate their claims under the clear and unambiguous authority of the Federal Arbitration Act. The Signatory Plaintiffs resisted arbitration, but in so doing conceded three important points: (1) the existence of and their assent to the arbitration agreements; (2) that the transactions in question substantially affected interstate commerce; and (3) that the arbitration agreements applied to their claims.[2] (Pet. App. 9a). The grounds of Plaintiffs' resistance to arbitration did not go to the making of the agreement to arbitrate. Instead, they contended that the underlying New Account Agreements were unenforceable under Alabama Code § 8-6-19(g) because Scott Wolas was not registered under the Alabama Securities Act in that name. The unenforceability of their New Account Agreements, they contended, also made the arbitration provisions within them unenforceable.

On February 1, 2002, the trial court denied the Motion to Compel Arbitration. On March 13, 2002, SAI filed its Notice of Appeal to the Supreme Court of Alabama.

2. The Alabama Supreme Court's Decision

The Alabama Supreme Court accepted the Plaintiffs' arguments and affirmed, holding that Ala. Code § 8-6-19(g) made the Customer Agreements, and hence their arbitration provisions, uenforceable.

Though Topic "A" in SAI's written argument to the Alabama Supreme Court was "The Federal Arbitration Act

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2. These concessions make it "clear and unmistakable" that the parties agreed to arbitrate the Plaintiffs' challenge to the legality of the underlying agreements with SAI. The question of arbitrability is therefore not for judicial determination. *See First Options of Chicago, Inc. v. Kaplan*, 514 U.S. 938 (1995); *Howsam v. Dean Witter Reynolds*, 537 U.S. 79, 123 S. Ct. 588, 591 (2002).

Requires Arbitration of the Plaintiffs' Claims," the court's opinion devotes *not even a single word* to the issue. Instead the court held that "The violations of the Alabama Securities Act rendered the SAI customer agreements unenforceable by SAI. Therefore, SAI is not entitled to seek arbitration under the provisions of those agreements, and the trial court did not err in denying SAI's motion to compel the Signatory Plaintiffs to arbitrate their claims." (Pet. App. 13a). There was no discussion whatsoever of any federal statutes or any federal court decisions, though many were called to the Court's attention by SAI, including the FAA, and *Prima Paint* and its progeny. There was no discussion whatever of the severability doctrine. The court's discussion was limited entirely to whether the agreement as a whole was unenforceable under state law.

The Alabama Supreme Court cited *Alabama Catalog Sales v. Harris*, 794 So.2d 312 (Ala. 2001) to support its decision. In *Alabama Catalog Sales*, the plaintiff alleged her payday loan contract was illegal and void under the Alabama Small Loan Act, and argued that the arbitration agreement, being part of the payday loan agreement, was therefore also void and unenforceable. The court in *Alabama Catalog Sales* relied on its decision in *Shearson Lehman Bros., Inc. v. Crisp*, 646 So.2d 613 (1994), which in turn relied heavily on *Three Valleys Municipal Water District v. E.F. Hutton & Co., Inc.*, 925 F.2d 1136 (9th Cir. 1991), to hold that allegations that a contract was void for reasons of illegality created an issue as to the existence of the underlying agreement, and that this extended to the arbitration agreement. Accordingly, the challenge to the underlying agreement was a decision for the courts, not an arbitrator. 792 So.2d at 316-317. The Ninth Circuit in *Three Valleys*, *supra*, held that the controlling distinction on the question of arbitrability was between void and voidable contracts. According to this distinction (which is not found in the language of the FAA), *Prima Paint* required that claims that an underlying contract was merely voidable went to arbitration, while claims that it was "void" raised an issue as to

the making of the agreement to arbitrate which therefore remained for the court to decide. *Alabama Catalog Sales*, 794 So.2d at 315, n.1. *Alabama Catalog Sales* applied *Three Valleys's* doctrinal innovation – the void/voidable distinction – to conclude that if an agreement was illegal under the state usury statute, then it was void and did not exist, and that this illegality in the underlying contract was fatal as well to the arbitration agreement.

The opinion *SAI v. Rogers*, however, contained none of this exposition. The Court merely held that the agreements with SAI were unenforceable under the Alabama Securities Act and that this unenforceability extended to the arbitration agreements. The court therefore affirmed the denial of SAI's motion to compel arbitration.

REASONS FOR GRANTING THE WRIT

Certiorari should be granted (1) to correct the manifest error of the Alabama Supreme Court, and reinforce the policies of FAA and this Court's many decisions on the subject; (2) to correct the other state courts that have likewise gone astray in this area, and (3) to eliminate the mischief arising from a certain doctrinal confusion that has crept into the decisions of several circuits and state courts and (4) to settle the extent to which the severability doctrine insulates an arbitration agreement from claims that the underlying agreement is illegal.

I. The Alabama Supreme Court Erred in Failing to Apply the Federal Arbitration Act and Relevant Supreme Court Decisions

In *Prima Paint* this Court considered the effect on an arbitration provision of an allegation that the underlying contract had been procured by fraud. The Court held that for purposes of deciding a motion to stay or compel arbitration under the Federal Arbitration Act, the terms of the FAA required that the arbitration clause be viewed as separate and distinct from the

underlying contract. 388 U.S. at 403. Under the severability doctrine, defects in the enforceability of the underlying contract, such as might arise from alleged fraud in the inducement of the underlying contract generally, did not affect the enforceability of the analytically separate and distinct arbitration agreement. "[T]he statutory language does not permit the federal court to consider claims of fraud in the inducement of the contract generally." *Id.* at 404. In the language of 9 U.S.C. § 4, such a claim does not put in issue "the making of the agreement to arbitrate" and so does not affect its enforceability. 388 U.S. 395, 404. In such a case, claims of fraud in the inducement of the underlying contract and other similar claims which do not suffice to put in issue the making of the agreement to arbitrate are to be decided by the arbitrator, provided such claims are within the scope of the arbitration agreement. *Id.* The "making of the agreement to arbitrate" could be put in issue by a claim that the *arbitration agreement itself* was specifically induced by fraud or was otherwise illegal. *Id.* at 403-4.

The Alabama Supreme Court erred by failing to consider or even mention controlling federal law on arbitrability. This Court has made clear that "the substantive law the Act created was applicable in state and federal court," *Southland Corp. v. Keating*, 465 U.S. 1, 12 (1984), to the limits of Congress' power under the Commerce Clause. *Allied-Bruce Terminix Cos. Inc. v. Dobson*, 513 U.S. 265, 270. Federal law requires enforcement of the parties' arbitration agreement in this case because, as in *Prima Paint*, the attack on the underlying agreement was merely that it was unenforceable, and did not relate specifically to the making of the agreement to arbitrate. There is no justification for the Alabama Supreme Court's failure to mention or apply controlling law. To devote not even a single word of the opinion to the relevant principles of federal law is an act of judicial defiance that cannot be allowed to stand.

II. The Social Policies of the Alabama Securities Act are No Impediment to Arbitration

In reaching its decision, the Alabama Supreme Court placed great reliance on the policies of the Alabama Securities Act. It explicitly referred to those policies in construing the facts to find a statutory violation, and in construing the knowledge element of § 8-6-19(g) to be of no help to SAI. "'Statutes intended for the public benefit are to be construed most favorably to the public.' [citations omitted]" (Pet. App. 10a). Yet this Court has made quite clear that the desirability of the social policies promoted by statutes has no bearing on the arbitrability of a dispute provided those policies may be vindicated through arbitration. As was explained in *Green Tree Financial Corp.-Alabama v. Randolph*, 531 U.S. 79 (2000):

> [W]e have recognized that federal statutory claims can be appropriately resolved through arbitration, and we have enforced agreements to arbitrate that involve such claims. *See, e.g., Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 109 S. Ct. 1917, 104 L. Ed. 2d 526 (1989) (Securities Act of 1933); *Shearson/American Express Inc. v. McMahon*, 482 U.S. 220, 107 S. Ct. 2332, 96 L. Ed. 2d 185 (1987) (Securities Exchange Act of 1934 and Racketeer Influenced and Corrupt Organizations Act); *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc.*, 473 U.S. 614, 105 S. Ct. 3346, 87 L. Ed. 2d 444 (1985) (Sherman Act). We have likewise rejected generalized attacks on arbitration that rest on "suspicion of arbitration as a method of weakening the protections afforded in the substantive law to would-be complainants." *Rodriguez de Quijas, supra*, at 481, 109 S. Ct. 1917. These cases demonstrate that even claims arising under a statute designed to further important social policies may be arbitrated because "'so long as the prospective

> litigant effectively may vindicate [his or her] statutory cause of action in the arbitral forum,'" the statute serves its functions. *See Gilmer*, [*Gilmer v. Interstate/Johnson Lane Corp.*, 500 U.S. 20, 24 (1991).] *supra*, at 28, 111 S. Ct. 1647 (quoting *Mitsubishi*, *supra*, at 637, 105 S. Ct. 3346).

531 U.S. at 89. Plaintiffs have made no showing that they cannot effectively vindicate their rights as investors in arbitration. Accordingly, the public protection policies of the Alabama Securities Act furnish no support for refusing to enforce the parties' arbitration agreements as written.

III. Most Federal Circuit Courts Hold That The Alleged Illegality of the Underlying Agreement is Arbitrable

The question of the effect on arbitration agreements of state licensing and regulatory statutes that make illegal or unenforceable any contracts that do not comply therewith has been squarely considered in the Fourth, Fifth, Sixth, Seventh and Eleventh Circuits. In each case, the courts held that under the FAA, *Prima Paint* and the severability doctrine, the asserted illegality of the underlying agreement did not put the making of the arbitration agreement in issue and had no effect on its enforceability. *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002) (illegality of "pay day" loan agreement claimed to be void *ab initio* under state usury statute did not relate specifically to the arbitration clause, which was enforceable where there was no issue of assent or applicability); *Lawrence v. Comprehensive Bus. Servs. Co.*, 833 F.2d 1159 (5th Cir. 1987) (alleged illegality of franchise agreement under Texas Accountancy Act did not affect enforceability of arbitration agreement under *Prima Paint*); *Burden v. Check into Cash of Kentucky, LLC*, 267 F.3d 483 (6th Cir. 2001) (illegality of "pay day" loan agreement from unlicensed lender claimed to be void *ab initio* under state usury statute and small loan licensing statute did not relate specifically to the arbitration clause, which was enforceable where there was no issue of assent

or applicability); *Sweet Dreams Unlimited, Inc. v. Dial-a-Mattress, Int'l*, 1 F.3d 639 (7th Cir. 1993) (unregistered franchise agreement subject to rescission under state law, but arbitration clause separable and enforceable under *Prima Paint*); *Harter v. Iowa Grain Co.*, 220 F.3d 544 (7th Cir. 2000) (arbitration agreement enforceable under *Prima Paint* notwithstanding attack on underlying contracts as illegal under Commodities Exchange Act).

The Eleventh Circuit cases warrant fuller discussion because they correctly enforce arbitration agreements when there is no issue as to the making of the agreement to arbitrate, and correctly do not enforce them when there is, and do so without reference to the void/voidable test.

In *John B. Goodman L.P. v. THF Construction, Inc.*, 321 F.3d 1094 (11th Cir. 2003), the plaintiff brought fraud and RICO claims. The defendant moved to enforce the arbitration clauses in the parties' construction contracts. The plaintiff resisted arbitration, arguing that defendant was not a licensed contractor so the contracts were unenforceable under Florida law. The Eleventh Circuit sent the question of whether the underlying contract was unenforceable to the arbitrator because the plaintiff's challenge went to the substance of the contract and not to its existence, and created no issue as to the making of the arbitration agreement.

Of particular interest is *Bess v. Check Express*, 294 F.3d 1298 (11th Cir. 2002), which involved a general attack on a pay day loan agreement as usurious and void *ab initio* under Alabama's Small Loan Act. The Court held that the allegations of illegality of the underlying loan agreement did not specifically put in issue the making of the arbitration agreement. Therefore, under *Prima Paint* an arbitrator rather than a court should decide those issues. The Court rejected plaintiff's reliance on *Chastain v. Robinson Humphrey Co.*, 957 F.2d 851 (11th Cir. 1992), in which the court did not enforce an arbitration agreement where the plaintiff claimed her signature had been forged on the

contract in question and she, therefore, had never agreed to arbitrate any claims between her and defendant:

> Likening his void *ab initio* allegations to the contentions in *Chastain* that no contract ever existed, Colburn argues that, as in *Chastain*, the court must determine the legality of the deferred payment transactions before deciding whether to compel arbitration. But the focus of the court's decision in *Chastain* . . . was on the question of assent, i.e., whether the parties mutually had agreed to the contracts. By contrast, Colburn urges that the transactions in this case are void, not because he failed to assent to the essential terms of the contracts, but because those terms allegedly render the contracts illegal under Alabama law. At bottom, Colburn challenges the *content* of the contracts, not their *existence*. . . . Therefore, the issue raised by Colburn – whether the deferred payment transactions are void as illegal – is one for the arbitrator, not the court.

Bess v. Check Express, 294 F.3d at 1305-6. While the focus on content vs. existence is an abstraction from the statutory test of whether the making of the agreement to arbitrate has been put in issue, there can be little doubt that *Bess* is correctly decided. In light of *Goodman* and *Bess*, it is clear that had the case at bar been filed in federal court the arbitration agreement would have been enforced. In fact, when other victims of "Hengst" presented their claim to the Middle District of Florida, it applied *Bess* and enforced the arbitration agreement. *Dupont v. Securities America, Inc.*, Case No. 6:01-cv-1195 (M.D. FL 6/26/02). The Alabama rule therefore promotes forum shopping, contrary to the strong federal policy favoring uniform application of the substantive federal law of arbitrability "We are unwilling to attribute to Congress the intent, in drawing on the comprehensive powers of the Commerce Clause, to create a right to enforce an

arbitration contract and yet make the right dependent for its enforcement on the particular forum in which it is asserted." *Southland Corp. v. Keating*, 465 U.S. 1, 16 (1984).

The only remedy for what the Alabama Supreme Court has done is to grant this petition.

IV. Other States Have Similarly Erroneous Decisions

The result in the case at bar is not an isolated incident unworthy of the Court's attention. There are five other states – New Hampshire, Florida, Illinois, Colorado and South Dakota – with similar decisions.

In *Riverwalk Apartments, LP v. RTM General Contractors, Inc.*, 779 So.2d 537 (Fla. 2d DCA 2000) the court held that a party who offers colorable evidence a contract is illegal cannot be compelled to arbitrate the threshold question of existence of an agreement to arbitrate. *But see* contrary Florida cases discussed in *Goodman L.P. v. THF Construction, Inc.*, 321 F.3d 1094, 1097-1098 (11th Cir. 2003).

In *Aste v. Metropolitan Life Ins. Co.*, 312 Ill.App. 972, 728 N.E.2d 629 (2000) the Illinois Security Law voided the underlying agreement because a securities salesperson was not registered. The court held this invalidity was fatal to the arbitration clause and that the difference between the underlying agreement and the arbitration agreement under the severability doctrine was "a distinction without a difference."

In *Nature's 10 Jewelers v. Gunderson*, 648 S.W.2d 804 (S.D. 2002), the court held that the lack of a franchisor's license made the underlying agreement illegal and void. Adopting the void-voidable distinction from the Ninth Circuit case of *Three Valleys Municipal Water District v. Hutton & Co.*, 925 F.2d 1136 (1991), the court held that the invalidity extended to the arbitration agreement.

In *RPT of Aspen v. Innovative Communications, Inc.*, 917 P.2d 340 (Colo. Ct. App. Div. IV 1996) the underlying contract was claimed to be illegal under a state anti-trust statute and therefore void. The court held that the severability doctrine was not applicable to allegations that the whole contract was illegal, and refused to enforce the arbitration agreement.

Each of these states has committed the same or similar error as the Alabama Supreme Court. Collectively these cases raise the important question of the extent to which the severability doctrine insulates arbitration agreements from claims that the underlying agreement is illegal or void. The question has lead to a split of authority and a substantial lack of uniformity in the application of the federal law of arbitrability. The historical objective of the FAA and the Court's jurisprudence in this area has been to achieve uniform national enforceability of arbitration agreements. That policy is frustrated as long as these six states (including Alabama) are allowed to persist in their erroneous application of the Federal Arbitration Act.

V. Abstractions Like The Ninth Circuit's Void – Voidable Test Are Poor Proxies for the Actual Test in the FAA

Many of the courts that have refused to enforce arbitration agreements in contracts alleged to be illegal have relied on the Ninth Circuit case *Three Valleys Municipal Water District v. E.F. Hutton & Co., Inc.*, 925 F.2d 1136 (9th Cir. 1991) which articulated a "void-voidable" test.

The distinction between void and voidable contracts in *Three Valleys* has been adopted by other Circuits. For example, the Second Circuit in *Sphere Drake Ins. Ltd., v. Clarendon National Ins.*, 263 F.3d 26 (2nd Cir. 2001) adopted it as a way of deciding a defense to arbitration based on a claim that an agent had exceeded his contracting authority: "While the teachings of *Interocean* and *Prima Paint* may appear conflicting, they can be sensibly harmonized by understanding that their outcomes implicitly – if not explicitly – rely on the distinction between

void and voidable contracts, a distinction already recognized in at least two other circuits." *Id.* at 31, citing *Sandvik AB v. Advent Int'l Corp.*, 220 F.3d 99, 106-07 (3rd Cir. 2000) and *Three Valleys* 925 F.2d at 1140. The Second Circuit summarized the void-voidable test as follows:

> If a party alleges that a contract is void and provides some evidence in support, then the party need not specifically allege that the arbitration clause in that contract is void, and the party is entitled to a trial on the arbitrability issue pursuant to 9 U.S.C.A. § 4 and the rule of *Interocean*. However, under the rule of *Prima Paint*, if a party merely alleges that a contract is voidable, then, for the party to receive a trial on the validity of the arbitration clause, the party must specifically allege that the arbitration clause is itself voidable.

Sphere Drake Ins. Ltd., v. Clarendon National Ins., 263 F.3d at 32. For examples of cases applying the void-voidable test, *see Alabama Catalog Sales v. Harris*, 794 So.2d 312 (Ala. 2001); *Party Yards, Inc. v. Templeton*, 751 S.2d 121 (Fla. 5th DCA 2000); and *Nature's 10 Jewelers v. Gunderson, supra.*

The difficulty with the void-voidable test is not that it lead to incorrect decisions in *Three Valleys* or *Sandvik* or the Second Circuit iteration of *Sphere Drake*. It is that the test is not the one codified in the FAA, and that it consequently leads to incorrect results as in *Alabama Catalog Sales* and *Party Yards*. The FAA's test is whether the "making of the agreement for arbitration" has been put in issue. 9 U.S.C. § 4. Cases in which there is a claim that the agreement was never signed such as *Sandvik AB, supra*, and *Chastain v. Robinson Humphrey Co.*, 957 F.2d 851 (11th Cir. 1992), and cases in which there is a claim that an agent has exceeded his contracting authority such as *Three Valleys, Sphere Drake Ins., Ltd. v. Clarendon National Ins., supra,* are all cases in which the making of the arbitration agreement was thusly put in issue and were therefore properly

not sent to arbitration. In such cases it is not necessary to abstract from the statutory test to the void-voidable test to yield this result. *See Bess v. Check Express*, 294 F.3d 1298, 1306 (11th Cir. 2002) (harmonizing *Three Valleys, Sphere Drake,* and *Sandvik AB* without using the void-voidable test). A useful discussion of these decisions and the statutory test is found in *Burden v. Check Into Cash of Kentucky, LLC*, 267 F.3d 483, 487-92 (6th Cir. 2001). *See also Sphere Drake Ins. Ltd., v. All American Ins. Co.*, 256 F.3d 587 (7th Cir. 2001) (explaining cases in terms of statutory test).

The void-voidable test is not the only abstraction employed by courts struggling to decide questions of arbitrability. There are also such formulations as the assent model or substance/existence test in *Bess v. Check Express*; fraud in the inducement vs. fraud in the factum in *Cancanon v. Smith, Barney, Harris, Upham & Co.*, 805 F.2d 998 (11th Cir. 1986); the "permeation" test of *Green v Mt. Diablo Hosp. Dist.*, 207 Cal.App.3d 63, 254 Cal.Rptr. 689 (1989); and the "signatory power" test in *Burden*.

As the Sixth Circuit noted in *Burden*, "while the 'fraud in the factum/fraud in the inducement distinction may offer a legitimate means of analy[sis],' the distinction 'may more confound than clarify the dispositive issue and its resolution.'" *Burden*, 267 F.3d at 489, citing *C.B.S. Employees Credit Union v. Donaldson, Lufkin & Jenrette Sec. Corp.*, 913 F.2d 1563, 1566 (6th Cir. 1990).

The error, and the split of authority, which ensues from the void-voidable test can be seen in cases in which the underlying contract is alleged to be void or unenforceable for lack of compliance with a particular licensing statute. The Alabama Supreme Court's decisions in *Alabama Catalog Sales* and this case, and the South Dakota Supreme Court's decision in *Nature's 10 Jewelers v. Gunderson*, 648 S.W.2d 804 (S.D. 2002) are worthy examples. The underlying contract was alleged in each case to be illegal and void for lack of a license. Applying the

void-voidable test, these courts held that the alleged illegality placed the existence of the agreements in question, precluding arbitration of that claim. But in functionally equivalent fact patterns, and applying instead the statutory test of whether the making of the arbitration agreement had been put in issue, the Fourth Circuit in *Snowden v. Checkpoint Check Cashing*, 290 F.3d 631 (4th Cir. 2002), the Seventh Circuit in *Sweet Dreams Unlimited, Inc. v. Dial-a-Mattress, Int'l*, 1 F.3d 639 (7th Cir. 1993), and the Eleventh Circuit in *Bess v. Check Express, supra*, held that such allegations do not put in issue the making of the arbitration agreement, but are instead merely challenge the substance or content of the underlying agreement.

In the case at bar, the alleged violations of the registration requirement of the Alabama Securities Act did not put in issue the making of the arbitration agreement. Consequently, SAI's motion to compel arbitration should have been granted.

VI. The Registration Requirement of the Alabama Securities Act Does Not Apply to "Any Contract," and so Cannot be Used to Invalidate an Arbitration Agreement

Apart from the failure to consider or apply controlling federal law, the decision reached in this case is contrary to § 2 of the FAA and this Court's binding precedents about the kind of contract defenses that may be relied upon to defeat an arbitration agreement. Section 2 of the Arbitration Act permits a party to nullify an agreement to arbitrate on "such grounds as exist at law or in equity for the revocation of *any* contract." (Emphasis added). In *Southland Corp. v. Keating*, *supra*, a provision of the California Franchise Investment Law made void any contract provision which purported to waive compliance with the law. 465 U.S. at 10. While the statute did not specifically invalidate arbitration agreements, it was construed to do so by the California Supreme Court. *Id.* In responding to a dissenting Justice, the Court's opinion made clear that contract defenses found in specialized regulatory codes like the California

Franchise Investment Law that are not generally applicable to "any contract" are not proper defenses to an arbitration agreement:

> Justice STEVENS dissents in part on the ground that § 2 of the Arbitration Act permits a party to nullify an agreement to arbitrate on "such grounds as exist at law or in equity for the revocation of any contract." We agree, of course, that a party may assert general contract defenses such as fraud to avoid enforcement of an arbitration agreement. We conclude, however, that the defense to arbitration found in the California Franchise Investment Law is not a ground that exists at law or in equity "for the revocation of *any* contract" but merely a ground that exists for the revocation of arbitration provisions in contracts subject to the California Franchise Investment Law. . . . If we accepted this analysis, states could wholly eviscerate Congressional intent to place arbitration agreements "upon the same footing as other contracts," H.R. Rep. No. 96, *supra*, 1, simply by passing statutes such as the Franchise Investment Law. We have rejected this analysis because it is in conflict with the Arbitration Act and would permit states to override the declared policy requiring enforcement of arbitration agreements.

Southland Corp. v. Keating, 465 US at 16, n.11. (Emphasis in original).

The same point was made in *Perry v. Thomas*, 482 U.S. 483, 492, n. 9 (1996) in the context of a state statute which was specifically directed against arbitration provisions in employment agreements. The Court held that Section 2 of the FAA preempted the statute, and explained the role of state law in determining questions of arbitrability:

> An agreement to arbitrate is valid, irrevocable, and enforceable, *as a matter of federal law*, see *Moses*

> *H. Cone Memorial Hospital v. Mercury Construction Corp.*, 460 U.S. 1, 24 (1983), "save upon such grounds as exist at law or in equity for the revocation of *any* contract." 9 U.S.C. § 2 (emphasis added). Thus state law, whether of legislative or judicial origin, is applicable if that law arose to govern issues concerning the validity, revocability, and enforceability of contracts generally.

Perry v. Thomas, 482 U.S. at 492 (emphasis in original). Under this reasoning, a statute directed specifically at arbitration clauses did not "comport with [the] requirement of § 2" that the grounds of state law attack be applicable to "*any* contract." *Id.*

Doctor's Associates, Inc. v. Casarotto, 517 U.S. 681 (1996) also involved a state statute that was specifically directed at arbitration clauses and which imposed a special notice requirement. "Montana's § 27-5-114(4) directly conflicts with § 2 of the FAA because the State's law conditions the enforceability of arbitration agreements on compliance with a special notice requirement not applicable to contracts generally." 517 U.S. at 687.

While these cases invalidated state laws that were directed specifically against arbitration clauses, the preemptive effect of § 2 of the FAA, by its plain terms, is not limited to that circumstance. State law defenses to arbitration that are limited to a particular kind of contract, or are drawn from a specialized regulatory code and are not applicable to invalidate "any contract," simply do not meet this requirement of § 2 and so have no effect on the validity of arbitration agreements. "We see nothing in the Act indicating that the broad principle of enforceability is subject to any additional limitations under state law." *Southland Corp. v. Keating*, 465 U.S. at 11. Thus, in *Lawrence v. Comprehensive Bus. Servs. Co.*, 833 F.2d 1159, 1162 (5th Cir. 1987) the Fifth Circuit, citing footnote 11 in *Southland* (quoted above) held that "Similarly, the Texas Accountancy Act of 1979 is not a ground that exists at law or in

equity for the revocation of any contract, and it cannot overcome the strong federal interest in arbitration."

Applying these principles to the case at bar it is quite evident that the asserted defense to arbitration, the unenforceability of contracts made or performed in violation of the registration requirement of the Alabama Securities Act, is not one that exists at law or equity for the revocation of "*any* contract." To cite just two examples, § 8-6-19(g) does not apply to contracts for the sale of goods, and does not apply to agreements to arbitrate, standing alone. Nor, under the doctrine of severability, does it apply to an arbitration agreement found in a customer agreement which is otherwise subject to the Alabama Securities Act. In plain terms, one does not need a state securities license just to make an agreement to arbitrate in the state of Alabama. Therefore, the Alabama Supreme Court decision to hold the arbitration agreement in this case unenforceable based upon § 8-6-19(g), a ground that does not exist for "any contract," was clearly contrary to § 2 of the FAA, *Southland*, *Perry* and *Doctor's Associates*.

VII. Certiorari Should Be Granted to Prevent The Policies of Federal Arbitration Law From Being Undermined

The policies behind federal arbitration law are to overcome judicial hostility to arbitration and to place arbitration agreements on an equal footing with other types of contracts. *Southland Corp. v. Keating*, 465 U.S. at 16-17, n.11. In addition, arbitration relieves crowded court dockets and resolves disputes with speed and finality. *Weinrott v. Carp*, 32 N.Y.2d 190, 298 N.E.2d 42 (1973) (justifying adoption of severability doctrine). These policies are frustrated by ill-conceived decisions that permit arbitration to avoided by the expedient of pleading non-compliance with a specialized licensing statute or with other state laws which invalidate contracts with illegal provisions. There are 39 states with securities statutes that invalidate

contracts that do not comply therewith.[3] Strong application of the severability doctrine is necessary to effectuate the purposes of federal arbitration law and defeat unceasing attempts to avoid it. If arbitration could be avoided upon the mere claim of fraud, there would hardly be any arbitration, "for it is easy to cry fraud." *Sphere Drake Ins. Ltd., v. All American Ins. Co.*, 256 F.3d at 590. The doctrine must also be strongly applied to state legislative attempts to limit arbitration. "If we accepted this analysis, states could wholly eviscerate Congressional intent to place arbitration agreements 'upon the same footing as other contracts,' . . . simply by passing statutes such as the Franchise Investment Law." *Southland Corp. v. Keating*, 465 U.S. at 16-17, n.11.

The new threat to federal arbitration law arises from a weakening of the severability doctrine through the use of state licensing statutes as pretexts to invalidate arbitration agreements that would clearly be enforced were the matter presented in federal court. Each state has literally dozens of specialized regulatory statutes which invalidate, to one degree or another, contracts within their scope that do not comply with their

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3. Alaska Code § 45.55.930(g); Arkansas Code § 23-42-106(g); Colorado Code § 11-51-604(10); Connecticut Code § 36b-29(h); Delaware Code § 7323(f); Idaho Code § 30-1446(4); Indiana Code § 23-2-1-19(h); Iowa Code § 502.502A(2); Kansas Code § 17-1268(d); Kentucky Code § 292-480(6); Maine Code Code § 10608(1); Maryland Code Code § 11-703(g); Mass. Code § 410(f); Mich. Code § 451.810(f); Minn. Code § 80A.23(9); Miss. Code § 75-71-727; Missouri Code § 409.4111(h); Montana Code § 30-10-307(4); Nebraska Code § 8-1118(5); Nevada Code § 90.840; New Hampshire Code § 421-B:25(IX); New Jersey Code § 49:3-71(h); New Mexico Code § 58-13B-55; North Carolina Code § 78A-56(h): North Dakota Code § 10-04-17 (voidable at purchaser's option); Ohio Code § 1707.43 (same); Oklahoma Code § 408(i); Pennsylvania Code § 508; Rhode Isl. Code § 7-11-802; South Carolina Code § 35-1-1540; South Dakota Code § 47-31A-410(h); Texas Code § 581-33(K); Utah Code § 61-1-22(8); Vermont Code § 4240(h); Washington Code § 21.20.430(5); West Virginia Code § 32-4-410(f); Wisconsin Code § 551.59(7); Wyoming Code § 17-4-122(f).

requirements. Cases have already been presented from the franchise, securities, financial and construction industries. Several states, including Alabama, have shown no compunction over invalidating arbitration agreements upon such grounds even though it is clear that they are not generally applicable contract defenses and even though it is clear that they do not put in issue the making of the arbitration agreement. Left unchecked, this trend will defeat the purposes of the FAA and this Court's many decisions on the subject.

CONCLUSION

For the foregoing reasons, the petition for a writ of certiorari should be granted.

Respectfully submitted,

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APPENDIX

APPENDIX A — OPINION OF THE SUPREME COURT OF ALABAMA RELEASED NOVEMBER 8, 2002

SUPREME COURT OF ALABAMA

OCTOBER TERM, 2002-2003

1011189

Securities America, Inc.

v.

Charles P. Rogers et al.

Appeal from Jefferson Circuit Court
(CV-01-6514)

WOODALL, Justice.

Securities America, Inc. ("SAI"), a defendant in an action pending in the Jefferson Circuit Court, appeals from the trial court's order denying its motion to compel arbitration of the claims made against it by the plaintiffs. We affirm.

I.

SAI is a securities broker-dealer registered with the United States Securities and Exchange Commission and is a member of the National Association of Securities Dealers. SAI offers securities to the public through a nationwide network of registered representatives. SAI is registered under the laws of Alabama to offer and sell securities.

Appendix A

The 10 plaintiffs — Charles P. Rogers, Margaret Rogers, M. Khris McAlister, Robert F. McCullough, William S. Ringland, Adrian Ringland, Jr., Adrian Ringland III, Bertha Ringland, George Edwards, and John Taliaferro — allege that "[t]his is a case about the criminal actions of a con artist . . . who assumed his college roommate's identity and stole over $1 million from the ten individual plaintiffs." Brief of Appellees, at 4. That alleged "con artist" is Scott Wolas, who, using the name of Allen Lee Hengst, his college roommate, became a registered representative of SAI, opened a branch office in Orlando, Florida, and obtained an Alabama securities license under that assumed name.

The plaintiffs allege that acting "[o]n behalf of SAI and in violation of the Alabama Securities Act, Wolas (masquerading [as] Allen Hengst) enticed each of [them] into investing in securities approved and supported by SAI." Brief of Appellees, at 6. Further, they allege that they "lost substantial amounts of [money] as a result of the negligent, wanton and fraudulent acts of Wolas and SAI." Brief of Appellees, at 7.

SAI contends that "[p]laintiffs' claims stem solely from alleged losses arising from their dealings in bogus gold certificates with [Wolas, masquerading as Hengst], a registered representative of . . . SAI." Brief of Appellant, at 7. Further, SAI states that, "unbeknownst to [it], [Wolas, masquerading as Hengst,] had been operating a Ponzi scheme[1] selling 'gold certificates' prior to his affiliation with

1. "The term 'ponzi scheme' refers to an investment scheme whereby returns to investors are financed, not through the success (Cont'd)

. . . SAI and apparently continued to do so after he became registered with the firm." Brief of Appellees, at 9.

Five of the plaintiffs — M. Khris McAlister, Robert F. McCullough, Charles P. Rogers, Margaret Rogers, and William S. Ringland (the "nonsignatory plaintiffs") — never opened an account with SAI and, therefore, never signed any agreement with SAI. On the other hand, the other five plaintiffs — Adrian Ringland, Jr., Adrian Ringland III, Bertha Ringland, George Edwards, and John Taliaferro (the "signatory plaintiffs") — opened brokerage accounts with SAI, signing and receiving documents concerning those accounts. The documents were presented to the signatory plaintiffs by Wolas, who signed the documents as SAI's registered representative, using the name "Allen Hengst."

Each signatory plaintiff signed a new account application, which contains the following language directly above the client-signature line:

> "I HEREBY ACKNOWLEDGE THAT I AM IN RECEIPT AND HAVE READ, UNDERSTOOD AND AGREED TO THE TERMS SET FORTH IN THE SAI CLIENT AGREEMENT AND THAT THIS ACCOUNT IS GOVERNED BY A PRE-DISPUTE ARBITRATION AGREEMENT WHICH I HAVE READ AND UNDERSTAND."

(Cont'd)
of an underlying business venture, but from the principal sums of newly attracted investors. . . . Initial investors are actually paid the promised returns, attracting additional investors." *In re Primeline Sec. Corp.*, 295 F.3d 1100, 1104 n.2 (10th Cir. 2002).

Appendix A

(Capitalization in original.) Additionally, George Edwards and John Taliaferro opened retirement accounts with SAI, signing applications that contain the following language directly above the customer-signature line:

> "I REPRESENT THAT I HAVE READ THE CUSTOMER AGREEMENT GOVERNING THIS ACCOUNT AND AGREE TO BE BOUND BY SUCH CUSTOMER AGREEMENT AS CURRENTLY IN EFFECT AND AS MAY BE AMENDED FROM TIME TO TIME. THIS ACCOUNT IS GOVERNED BY A PRE-DISPUTE ARBITRATION AGREEMENT. . . . I ACKNOWLEDGE RECEIPT OF THE PRE-DISPUTE ARBITRATION AGREEMENT."

(Capitalization in original.)

All the signatory plaintiffs established their accounts as option accounts, which required them to execute option account agreements. Those agreements contain the following language directly above the customer-signature line:

> "I REPRESENT THAT I HAVE READ THE TERMS AND CONDITIONS GOVERNING THIS ACCOUNT AND AGREE TO BE BOUND BY SUCH TERMS AND CONDITIONS AS CURRENTLY IN EFFECT AND AS MAY BE AMENDED FROM TIME TO TIME. THIS ACCOUNT IS GOVERNED BY A PRE-DISPUTE ARBITRATION AGREEMENT

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> . . . . I ACKNOWLEDGE RECEIPT OF THE PRE-DISPUTE ARBITRATION AGREEMENT."

(Capitalization in original.)

The predispute arbitration agreement contained in the SAI customer agreement, which agreement is referenced in the separate agreements executed by all the signatory plaintiffs, provides in pertinent part:

> "I AGREE THAT ALL CONTROVERSIES THAT MAY ARISE BETWEEN US CONCERNING ANY ORDER OR TRANSACTION, OR THE CONTINUATION, PERFORMANCE OR BREACH OF THIS OR ANY OTHER AGREEMENT BETWEEN US, WHETHER ENTERED INTO BEFORE, ON, OR AFTER THE DATE THIS ACCOUNT IS OPENED, SHALL BE DETERMINED BY ARBITRATION BEFORE A PANEL OF INDEPENDENT ARBITRATORS SET UP BY EITHER THE NEW YORK STOCK EXCHANGE, INC., OR NATIONAL ASSOCIATION OF SECURITIES DEALERS, INC., AS I MAY DESIGNATE."

(Capitalization in original.)

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II.

On October 19, 2001, the plaintiffs sued SAI and Wolas, alleging that the "action arises out of [their] financial investments . . . made through SAI's agent, principal and employee — the so-called 'Allen Lee Hengst' — the most recent alias of Scott J. McKay Wolas." Seeking both compensatory and punitive damages, the complaint asserted claims of fraudulent misrepresentation and deceit; fraudulent suppression and concealment; negligent or wanton hiring, training, and supervision; breach of fiduciary duty; violation of § 8-6-17, Ala. Code 1975; and violation of §§ 8-6-3 and -4, Ala. Code 1975.

On December 13, 2001, SAI answered the complaint. It asserted as a defense that "[p]laintiffs' claims are subject to mandatory arbitration agreements." On that same date, SAI filed a motion to dismiss, or, alternatively, to stay the proceedings and compel arbitration. SAI attached to that motion the affidavit of Kevin Zemann, its director of regional supervision, to which were attached copies of those documents signed and/or received by the signatory plaintiffs.

On December 19, 2001, SAI filed a brief in support of its motion to compel arbitration. The brief was accompanied by the affidavit of Lamar S. Jones, SAI's vice president and chief operations officer. That affidavit described the interstate nature of SATs business, as well as aspects of a sale-of-securities transaction.

On January 30, 2002, the plaintiffs filed a brief in opposition to SAI's motion to compel arbitration. On February 1, 2002, the trial court denied SAI's motion. SAI appealed.

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III.

This Court recently reiterated the standard of review of a denial of a motion to compel arbitration:

> "'This Court reviews the denial of a motion to compel arbitration de novo. *Green Tree Fin. Corp. v. Vintson*, 753 So. 2d 497, 502 (Ala. 1999); *Patrick Home Ctr., Inc. v. Karr*, 730 So. 2d 1171, 1172 (Ala. 1999). The party seeking to compel arbitration has the initial burden of proving the existence of a contract calling for arbitration and proving that the contract evidences a transaction substantially affecting interstate commerce. *TranSouth Fin. Corp. v. Bell*, 739 So. 2d 1110, 1114 (Ala. 1999); *Sisters of the Visitation v. Cochran*, 775 So. 2d 759 (Ala. 2000). "[A]fter a motion to compel arbitration has been made and supported, the burden is on the nonmovant to present evidence that the supposed arbitration agreement is not valid or does not apply to the dispute in question." *Jim Burke Auto., Inc. v. Beavers*, 674 So. 2d 1260, 1265 n.1 (opinion on application for rehearing) (Ala. 1995).'"

SouthTrust Bank v. Ford, [Ms. 1010124, May 17, 2002] __ So. 2d __, __ (Ala. 2002) (quoting *American Gen. Fin., Inc. v. Morton*, 812 So. 2d 282, 284 (Ala. 2001)).

As previously discussed, the signatory plaintiffs had entered into written agreements with SAI, while the nonsignatory plaintiffs had not. Therefore, the controlling principles must be applied separately to each group of plaintiffs.

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IV.

The trial court refused to compel the nonsignatory plaintiffs to arbitrate their claims against SAI. On appeal, SAI argues that although "[t]he non-signatory plaintiffs are complete strangers to [it]," they "should be required to arbitrate their claims just like any other SAI 'customer.'" Brief of Appellant, at 30. SAI's argument has no merit.

SAI, as the party seeking to compel arbitration, had the initial burden of proving the existence of a contract calling for arbitration of the claims of the nonsignatory plaintiffs. That threshold burden is imposed upon the party seeking to compel arbitration because "'"a party cannot be required to submit to arbitration any dispute he has not agreed to submit."'" *Cook's Pest Control, Inc. v. Boykin*, 807 So. 2d 524, 526 (Ala. 2001) (quoting *Old Republic Ins. Co. v. Lanier*, 644 So. 2d 1258, 1260 (Ala. 1994), quoting in turn *A.G. Edwards & Sons, Inc. v. Clark*, 558 So. 2d 358, 362 (Ala. 1990)). SAI provided no evidence of any contract by which any nonsignatory plaintiff agreed to submit any dispute to arbitration.

SAI argues that the nonsignatory plaintiffs should be compelled to arbitrate their disputes, because, SAI alleges, "the non-signatory plaintiffs are attempting to avail themselves of the benefits of [the SAI customer agreement]." Brief of Appellant, at 31. The nonsignatory plaintiffs respond that their claims are not based upon SAI's customer agreement and that they "do not allege breach of contract." Brief of Appellees, at 27. Our review of the complaint indicates that the plaintiffs are not attempting "to enforce

selectively the provisions of . . . SAI's customer agreement," as alleged by SAI. Brief of Appellant, at 31. Without addressing the legal merits, if any, of SAI's argument, we conclude that the argument must fail, because of a total absence of factual support.

The trial court did not err in refusing to compel the arbitration of the claims of the nonsignatory plaintiffs. Therefore, to that extent, its order denying SAI's motion to compel arbitration must be affirmed.

V.

When SAI moved to compel arbitration of their claims, the signatory plaintiffs did not dispute the existence of contracts calling for arbitration, which contracts evidence transactions substantially affecting interstate commerce. Therefore, the burden shifted to the signatory plaintiffs to present evidence indicating that the arbitration agreements are not valid or that they do not apply to the disputes in question. While the signatory plaintiffs did not dispute the applicability of the agreements, they did contend that the agreements are not valid or enforceable.

In *Alabama Catalog Sales v. Harris*, 794 So. 2d 312, 315 (Ala. 2000), "[t]he ultimate issue . . . [was] whether the trial court, or an arbitrator, determines the validity of a contract that contains a provision requiring that all claims arising therefrom be arbitrated." (Footnote omitted.) This Court held that "the trial court, as opposed to the arbitrator, must decide the ultimate question relating to the legality and enforceability of the contracts." 794 So. 2d

at 317. Thus, it was appropriate for the trial court, as it is for this Court, to address the enforceability by SAI of the SAI customer agreements.

The parties agree that SAI and its registered representatives are subject to the Alabama Securities Act, codified at § 8-6-1 *et seq.*, Ala. Code 1975 ("the Act"). The purpose of the Act is to protect the public from fraudulent, dishonest, or unethical practices in the securities business. See Comment to § 8-6-3, Ala. Code 1975. "Statutes intended for the public benefit are to be construed most favorably to the public. *Gant v. Warr*, 286 Ala. 387, 240 So. 2d 353 (1970)." *St. Paul Fire & Marine Ins. Co. v. Elliott*, 545 So. 2d 760, 762 (Ala. 1989).

The Act requires that every person engaged in the business of effecting transactions in securities in Alabama be registered with the Alabama Securities Commission ("the Commission"). See, generally, § 8-6-3. Specifically, § 8-6-3(a) provides: "It is unlawful for any person to transact business in this state as a dealer or agent for securities unless he is registered under this article. It is unlawful for any dealer or issuer to employ an agent unless the agent is registered."[2] There is no evidence indicating that Scott Wolas was registered to sell securities in Alabama. Instead, it is undisputed that, because of Wolas's dishonesty, the Commission registered Allen Hengst, who had no knowledge that Wolas had assumed his identity for that purpose. Therefore, we must conclude that Wolas and SAI violated § 8-6-3(a).

---

2. The Act defines "agent" as "[a]ny individual other than a dealer who represents a dealer or issuer in effecting or attempting to effect sales of securities. . . ." § 8-6-2(2), Ala. Code 1975.

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The signatory plaintiffs argue that the SAI customer agreements containing the arbitration provision cannot be enforced, because, they argue, the Act "prohibits enforcement of contracts made in violation of its provisions." Brief of Appellees, at 9. SAI responds that the Act "offers no impediment to the enforcement of the arbitration agreements," because "SAI did not know that [Wolas, masquerading as Hengst,] was anyone other than who he purported to be." Reply Brief of Appellant, at 5. Our analysis of § 8-6-19(g), Ala. Code 1975, resolves this issue in favor of the signatory plaintiffs.

Section 8-6-19(g) provides, in pertinent part:

> "(g) No person who has made or engaged in the performance of any contract in violation of any provision of this article . . . *or* who has acquired any purported right under such contract *with knowledge of the facts by reason of which its making or performance was in violation*, may base any action on the contract."

(Emphasis added.)

As previously stated, we must construe this statute most favorably to the public, including the signatory plaintiffs. Therefore, we read it as stating, in relevant part, that "no person who has made or engaged in the performance of any contract in violation of any provision of the Act may base any action on the contract." Therefore, SAI is not entitled to enforce the arbitration provision in its customer agreements.

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As previously discussed, SAI contends that it is entitled to enforce the arbitration agreements because it had no knowledge of any violation of the Act. SAI's argument is based on the knowledge requirement in § 8-6-19(g), emphasized in our quotation of that provision. SAI would have us construe the statute to mean, in relevant part, that "no person who has made or engaged in the performance of any contract in violation of any provision of the Act, with knowledge of the facts by reason of which its making or performance was in violation, may base any action on the contract." However, not only does such a construction fail to construe the statute in favor of the public, it also fails to consider another relevant rule of statutory construction.

In *White v. Knight*, 424 So. 2d 566, 567-68 (Ala. 1982), this Court discussed the "doctrine of last antecedent":

> "[P]laintiff argues that the language [of the Code section] is ambiguous, and being so dictates the use of the 'doctrine of last antecedent' in discovering its meaning:
>
> > "'By what is known as the doctrine of the "last antecedent," relative and qualifying words, phrases, and clauses, are to be applied to the words or phrase immediately preceding, and are not to be construed as extending to or including others more remote; . . . '

citing 82 C.J.S. *Statutes* § 334 (1953).

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> "We appreciate the application of this general rule of statutory construction; however, we also note from the cited section that the doctrine is only an aid to construction and 'will not be adhered to where extension to a more remote antecedent is clearly required by a consideration of the entire act. . . . Where several words are followed by a clause as much applicable to the first and other words as to the last, the clause should be read as applicable to all.' *Ibid.* See also 2A Sutherland Statutory Construction 47.33 (Sands 4th ed. 1973)."

The antecedent immediately preceding the phrase containing the knowledge requirement is a "person . . . who has acquired any purported right under any . . . contract [in violation of any provision of the Act]." Construing the statute in favor of the public, we see no reason to apply the knowledge requirement to the more remote antecedent, that is, to a "person who has made or engaged in the performance of any contract in violation of any provision of [the Act]."

The violations of the Alabama Securities Act rendered the SAI customer agreements unenforceable by SAI. Therefore, SAI is not entitled to seek arbitration under the provisions of those agreements, and the trial court did not err in denying SAI's motion to compel the signatory plaintiffs to arbitrate their claims.

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VI.

For the reasons stated above, the order of the trial court is affirmed.

AFFIRMED.

Houston, Lyons, Brown, Johnstone, and Stuart, JJ., concur.

Moore, C.J., concurs in the result.

Harwood, J., recuses himself.

APPENDIX B — CASE ACTION SUMMARY CONTINUATION

ALABAMA JUDICIAL DATA CENTER
CASE ACTION SUMMARY CONTINUATION
CIRCUIT CIVIL

IN THE CIRCUIT COURT OF JEFFERSON COUNTY

JUDGE: JACK D. CARL

FILED: 10/19/2001
TYPE: FRAUD
TYPE TRIAL: JURY

CHARLES P ROGERS ET AL

VS

SECURITIES AMERICA INC ET AL

DATE 1:	CA:	CA DATE:
DATE 2:	AMT:	$.00 PAYMENT

* * *

2/1/02 . . . Defendant Securities America, Inc.'s Motion To Dismiss . . . etc . . . filed 12/13/01 is DENIED

s/ Jack D. Carl

APPENDIX C — ORDER OF THE SUPREME COURT OF ALABAMA OVERRULING APPLICATION FOR REHEARING DATED FEBRUARY 7, 2003

IN THE SUPREME COURT OF ALABAMA

February 7, 2003

1011189

Securities America, Inc.

v.

Charles P. Rogers et al.

(Appeal from Jefferson Circuit Court: CV-01-6514)

ORDER

IT IS ORDERED that the application for rehearing filed in this cause is overruled.

Application for Rehearing Overruled – No Opinion

WOODALL, J. – Moore, C.J., and Houston, Lyons, Brown, Johnstone, and Stuart, JJ., concur; Harwood, J., recuses.

APPENDIX D — RELEVANT STATUTES

Federal Statutory Provisions

Section 2. Validity, irrevocability, and enforcement of agreements to arbitrate

> A written provision in any maritime transaction or a contract evidencing a transaction involving commerce to settle by arbitration a controversy thereafter arising out of such contract or transaction, or the refusal to perform the whole or any part thereof, or an agreement in writing to submit to arbitration an existing controversy arising out of such a contract, transaction, or refusal, shall be valid, irrevocable, and enforceable, save upon such grounds as exist at law or in equity for the revocation of any contract.

Section 3. Stay of proceedings where issue therein referable to arbitration

> If any suit or proceeding be brought in any of the courts of the United States upon any issue referable to arbitration under an agreement in writing for such arbitration, the court in which such suit is pending, upon being satisfied that the issue involved in such suit or proceeding is referable to arbitration under such an agreement, shall on application of one of the parties stay the trial of the action until such arbitration has been had in accordance with the terms of the agreement, providing the applicant for the stay is not in default in proceeding with such arbitration.

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Section 4. Failure to arbitrate under agreement; petition to United States court having jurisdiction for order to compel arbitration; notice and service thereof; hearing and determination

A party aggrieved by the alleged failure, neglect, or refusal of another to arbitrate under a written agreement for arbitration may petition any United States district court which, save for such agreement, would have jurisdiction under title 28, in a civil action or in admiralty of the subject matter of a suit arising out of the controversy between the parties, for an order directing that such arbitration proceed in the manner provided for in such agreement. Five days' notice in writing of such application shall be served upon the party in default. Service thereof shall be made in the manner provided by the Federal Rules of Civil Procedure. The court shall hear the parties, and upon being satisfied that the making of the agreement for arbitration or the failure to comply therewith is not in issue, the court shall make an order directing the parties to proceed to arbitration in accordance with the terms of the agreement. The hearing and proceedings, under such agreement, shall be within the district in which the petition for an order directing such arbitration is filed. If the making of the arbitration agreement or the failure, neglect, or refusal to perform the same be in issue, the court shall proceed summarily to the trial thereof. If no jury trial be demanded by the party alleged to be in default,

or if the matter in dispute is within admiralty jurisdiction, the court shall hear and determine such issue. Where such an issue is raised, the party alleged to be in default may, except in cases of admiralty, on or before the return day of the notice of application, demand a jury trial of such issue, and upon such demand the court shall make an order referring the issue or issues to a jury in the manner provided by the Federal Rules of Civil Procedure, or may specially call a jury for that purpose. If the jury find that no agreement in writing for arbitration was made or that there is no default in proceeding thereunder, the proceeding shall be dismissed. If the jury find that an agreement for arbitration was made in writing and that there is a default in proceeding thereunder, the court shall make an order summarily directing the parties to proceed with the arbitration in accordance with the terms thereof.

Alabama Statutory Provisions

Section 8-6-3 Registration and bonds of dealers and salesmen. (Excerpt)

(a) It is unlawful for any person to transact business in this state as a dealer or agent for securities unless he is registered under this article. It is unlawful for any dealer or issuer to employ an agent unless the agent is registered.

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(b) It is unlawful for any person to transact business in this state as an investment adviser or as an investment adviser representative unless:

(1) He is so registered under this article;

Section 8-6-19 Civil liabilities of sellers, agents, etc.; remedies of purchasers. (Excerpts)

(g) No person who has made or engaged in the performance of any contract in violation of any provision of this article or any rule or order hereunder or who has acquired any purported right under any such contract with knowledge of the facts by reason of which its making or performance was in violation, may base any action on the contract.